

A. COMPUTER-RELATED ORGANIZATIONS

by

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1. Introduction

The last few years have witnessed a dramatic increase in the number of personal computers used in both home and business. Groups composed of individuals interested in maximizing their (or their company's) use of these devices have grown with equal rapidity. The variety of groups has presented the Service with several issues to consider when processing applications for exemption. The purpose of this article is to discuss the tax exempt status of computer related organizations. We will note the evolution of the Service's position with respect to such organizations, describe some current types of computer-related organizations, and discuss the available precedents which can be used in analyzing such cases to ensure consistency.

There is nothing magical about computers. Use of a computer in a particular activity does not change the underlying nature of the activity. Use of a computer makes any given activity neither more nor less educational. The same issues that we consider in determining exemption, such as legislative activity and private benefit, arise in this area as in any other.

One problem common to many cases concerning computer-related organizations is language. Computer enthusiasts tend to use a jargon that often does not translate easily into the language of the federal tax laws. This may make it difficult to determine what particular activities an organization is engaged in. It may be necessary to ask an organization to describe its activities in "lay" terms, or provide an interpretation and ask for comments or corrections. These requests and descriptions should, of course, be in writing in order to become a part of the administrative record. Other suggestions for case development will be provided throughout this article.

2. Evolution of the Service's Position -- IRC 501(c)(3)

Much of the published precedent dealing with computer-related organizations is twenty years old, dating from well before the extraordinary growth in the use of personal computers. At the time these precedents were first being developed, personal computers did not exist. Businesses that used

computers used large mainframe computers. Key punch operators punched holes in computer cards, which were then "fed" to the computer to generate financial reports, schedules, or whatever. Because these computers were extremely expensive, only the largest businesses could afford them. In addition, there was little or no standardization among manufacturers with regard to the hardware provided, the software used as the mainframe operating system, or the applications programs run on those mainframe computers.

The first revenue rulings dealing with computer-related organizations were issued in 1974. Rev. Rul. 74-116, 1974-1 C.B. 127, discusses the qualification under IRC 501(c)(3) of a membership association devoted to developing and exchanging research data among users of a specific type of computer. Membership is limited to organizations that use this specific computer. The organization also serves as liaison between users and the manufacturer of the computer. The organization conducts meetings and seminars at which operational and technical problems relating to the use of this computer are discussed. The organization publishes reports of its meetings and seminars, as well as a monthly newsletter to keep members informed of current scientific and technical data of special interest to them as users of the computer. A section of the newsletter is devoted to advice and other comments from the manufacturer relating to the use of the computer. By making specialized information available to its members under the circumstances described above, the organization serves the private interest of its members rather than a public interest. Accordingly, the organization is not described in IRC 501(c)(3).

This ruling makes no reference to private benefit, if any, to the manufacturer. Furthermore, this ruling follows the general line of reasoning under IRC 501(c)(3) that organizations which **both** restrict their membership **and** limit the benefits of their educational activities to their members **may** fail to qualify for exemption due to lack of public benefit. See, for example, Rev. Rul. 80-302, 1980-2 C. B. 182 (organization limited to members of a particular family formed to compile genealogical data on and promote social activities among its family members is not exempt) and Rev. Rul. 73-439, 1973-2 C.B. 176 (organization whose members are selected based on compatibility and who holds closed meetings consisting of discussion of topics of personal interest is not exempt).

Rev. Rul. 74-614, 1974-2 C.B. 164, describes an organization of exempt colleges and universities that provides the organizational structure for a regional network of computers used by its members to collect and disseminate scientific and educational information to exempt members' faculties and students and

concludes that it is operated exclusively for charitable purposes and described in IRC 501(c)(3). The organization also maintains a staff to conduct research into the technical and managerial problems that arise from the operation of a regional computer network, devise solutions to those problems, and disseminate the results of its research. The results of this research are made available not only to members but also to the general public. The computer network is not used for administrative matters such as class scheduling, billing, or processing applications. By providing a coordinated program enabling the member institutions, including faculty and students, to benefit from the research and scientific projects developed by the various institutions, the organization is advancing education and therefore is described in IRC 501(c)(3).

The rationale behind Rev. Rul. 74-614 was discussed in G.C.M. 38050 (August 15, 1979), which considers the effect of non-exempt participants in such a network. The G.C.M. points out that the educational purpose of any tax exempt library is "the dissemination of information to the widest possible consuming public." Many public libraries, for instance, make their services available to for-profit corporations, which use access to those services for private gain. We do not revoke the exemption of the public library because its services are used in the course of profit-seeking activities. Therefore, the participation of non-exempt organizations in a network similar to the one described in Rev. Rul. 74-614 will not preclude exemption or result in unrelated business income. Of course, the G.C.M. continues,

"Were they to begin looking to private, nonexempt organization receipts to fund a disproportionate share of their activities, or were they to develop a membership that was heavily weighted toward the private sector, we would suggest careful reconsideration of their exempt status to see whether their operations really are consistent with one or more exclusively charitable purposes."

We will take another look at this revenue ruling when we discuss bulletin boards and on-line services later in this article.

3. Evolution of the Service's Position -- IRC 501(c)(6)

The first ruling published in this area was Rev. Rul. 74-147, 1974-1 C.B. 136, which describes a nonprofit organization whose members represent diversified businesses that use digital computers produced by various manufacturers. Its purpose is to improve the efficiency of its members' use of

computers. The organization holds semi-annual conferences, lasting from two to four days, at which operational and technical problems relating to computer use are discussed. Nonmembers are invited to attend the conferences and are encouraged to join as members. The organization does not provide counseling or other services to its members with respect to specific individual problems.

Here, the common business interest of the members of the organization is their common business problems concerning the use of digital computers. The primary objective of the organization is to provide a forum for the exchange of information that will lead to more efficient use of computers by its members and other interested users, and thus improve the overall efficiency of the business operations of each. Accordingly, the organization qualifies for exemption under IRC 501(c)(6).

There is, however, a somewhat troubling lack of consistency in this ruling. What about businesses that don't use computers at all? How are they benefitted by the activities of this organization? Isn't this organization benefitting only a segment of a line of business, the segment that uses computers? These questions are discussed in G.C.M. 39062 (November 22, 1983):

"The organization described in that case benefitted only those businesses that used computers in their operations. On the other hand, it is reasonable to suppose that if computers become useful to an industry, competitive forces would dictate that the industry as a whole would become computerized within a relatively short period of time. Under those circumstances, the organization described in Rev. Rul. 74-147, by catering to computer users within various industries, could be said to be serving the interests of a broad-based group and could be described as promoting a line of business as required by the regulations."

Thus, it would appear that the holding in Rev. Rul. 74-147 is based on the assumption that everyone in a given industry will soon begin to use computers and thus benefit from the organization's activities. The ruling also appears to equate "line of business" with "broad-based group." The term "line of business" has elsewhere been interpreted to mean either an entire industry or all components of an industry within a geographic area. Therefore, it would be appropriate to argue that a group such as the one described in Rev. Rul. 74-147 benefits even those businesses that do not currently use computers, because it can provide them with additional resources for making such decisions as whether or not to use computers,

which software or hardware works best for their type of business, and how to set up training programs.

Rev. Rul. 83-164, 1983-2 C.B. 95, represents the other side of the 501(c)(6) coin. It describes an organization formed to develop and disseminate information pertaining to the electronic data processing equipment manufactured by the M Corporation. Its membership is made up primarily of representatives of diversified businesses that use computers produced by M. Membership is also open to representatives of other businesses that do not use M's computers. The organization holds conferences at which operational and technical problems relating to computer use are discussed. Nonmembers are invited to attend the conferences and are encouraged to join as members. The speakers at the conferences typically include members as well as recognized professionals in the computer industry. Also, some representatives of M attend and disseminate current information relative to M's equipment.

Rev. Rul. 83-164 concluded that the organization did not qualify for exemption under IRC 501(c)(6). In addition to promoting the common business interest of its members, a business league exempt under IRC 501(c)(6) must also seek to improve conditions in one or more lines of business. The term "line of business" has been interpreted to mean either an entire industry or all components of an industry within a geographic area. By directing its activities only to the users of brand M computers, the instant organization is directing its activities towards the improvement of business conditions in only segments of the various lines of business to which its members belong. Because it limits its activities to the users of M computers, the organization helps to provide a competitive advantage to M and to its customers at the expense of M's competitors and their customers that use other brands of computers. Thus, the organization's activities are not directed towards the improvement of business conditions in one or more lines of business within the meaning of Regs. 1.501(c)(6)-1.

The position taken by the Service in Rev. Rul. 83-164 was upheld by the District Court in National Prime Users Group, Inc. v. U.S., 60 AFTR 2d 87-5564 (D.C. Md 1987). Relying heavily on the Supreme Court's decision in National Muffler Dealers Association, Inc. v. U.S. 440 U.S. 472 (1979), the District Court held that an organization whose membership was effectively limited to users of a particular brand of computer was not described in IRC 501(c)(6). The District Court concluded that the Group did not promote the interests of a line of business, but only those segments of a line of business that used Prime computers. The District Court also noted that the Group's activities and methods of operation

provided a competitive advantage to Prime, at the expense of other computer manufacturers.

This position was again sustained by the U.S. District Court for the Northern District of Illinois and the Court of Appeals for the 7th Circuit in Guide International Corporation v. U.S., 948 F. 2d 360. The appeals court said:

"... while Guide's members reflect a wide variety of businesses, no single business is enhanced and Guide only benefits IBM and those individuals within various lines of business who use IBM mainframes. Moreover, the district court found that Guide primarily advances IBM's interests and that any benefit to its members and other data processing companies who use information prepared by Guide is incidental. We agree with the district court's characterization of Guide as a powerful marketing tool for IBM. Guide's conferences provide IBM customers with the opportunity to learn about IBM products and services and IBM receives feedback about those products and services which influences product development. The district court properly found that Guide fails to qualify as an exempt business league under [section] 501(c)(6)."

The most important point to remember from this discussion is that it concerns qualification under IRC 501(c)(6) and not any other Code section. The "line of business" requirement is unique to that Code section and has no counterpart in any other. The Prime and Guide cases should **not** be cited in cases dealing with applications for exemption under IRC 501(c)(3).

Note also that membership in the organization described in Rev. Rul. 83-164 was theoretically open to any interested person. However, its activities were such as would attract only businesses using M computers. G.C.M. 37718 (October 11, 1978), discusses whether an organization that allows open membership but whose activities are such as would attract only members from a particular segment of the industry should be recognized as exempt under IRC 501(c)(6). In concluding that it should not, the G.C.M. reasons that if the association's activities are such as to only attract a segment of an industry, then neither the membership nor the activities requirement of Regs. 1.501(c)(6)-1 is satisfied. A business league's membership must reflect a broad sector of the industry and its activities must be directed to the general improvement of industry conditions as a whole. Administering this provision requires us to obtain a detailed information about an organization's actual or proposed activities, even if

membership appears, on its face, to be open to an entire industry.

4. Types of Organizations

The computer world and the types of organizations applying for exemption today do not bear much resemblance to the computer related organizations described in the published precedents of twenty years ago. The mainframe computer is now but one small part of the computing universe. The personal computer now accounts for most computer use in business. For example, an office might use stand-alone DOS-based personal computers for single-user word processing, and use another system, such as a networked UNIX-based minicomputer, for office-wide inventory control accessed by multiple users. A key feature of these machines is the ability to exchange, share, and use data in applications regardless of the particular brand of computer.

A. Special Interest Groups (SIGs), Computer User Groups (CUGs), and Like Organizations

Perhaps the most common computer organization is the general computer club or society. Such groups often include many special-interest subgroups. Many of the larger ones sponsor their own bulletin board systems.

Users groups are either hardware or software based. Hardware based groups are typically composed of users of a particular type or brand of hardware. For example, such a group could consist of users of IBM-compatible personal computers in an area. Bear in mind that the latter refers to compliance with an industry standard, not a brand name. Many personal computers today are based on a hardware standard initially developed for the IBM PC(tm). The standard is usually known as Industry Standard Architecture (ISA). There have been many subsequent improvements and variations of ISA too numerous to describe here. Suffice it to say that the emphasis today in the computer industry has been in the direction of interoperability of systems, interchangeability of computer parts, and "open" hardware architectures.

Software based groups are also common and are typically composed of users of a particular program, including operating systems. To be useful, such groups must often limit their interest to a particular product or subject. User groups are rarely established by, controlled by, or significantly funded by, the manufacturer. They often maintain some regular form of communication with the manufacturer, but the relationship between the two often approaches adversarial.

For example, user groups are often the first to announce the existence of "bugs" in software, and criticize software developers for not finding them in the first place or fixing them quickly enough. Furthermore, the existence of a user group is not used by manufacturers as a marketing tool. A careful review of advertising in computer magazines intended for the general public will not reveal a single advertisement for hardware or software that so much as mentions the existence of a user group. The situation may be different in the case of specialized business software or hardware marketed chiefly by direct mail or by a sales force. In either case, we cannot assume or conclude that a user group benefits the manufacturer unless facts show manufacturer involvement in the organization's activities.

B. Bulletin Board Systems (BBSs)

Bulletin Board Systems (BBSs) are host computers or groups of computers that users can call from their own computers using a telephone line and modem. As the name host implies, others, not the owners of the computer systems, are allowed to "log-in" to the systems to leave and read messages (hence the name bulletin board), leave or retrieve software (referred to as "uploading" and "downloading"), or play online computer games against the host system or other users.

BBSs range in size from small home systems operated by hobbyists to the enormous for-profit, full-service, online "information services" such as America Online(tm), CompuServe(tm), Delphi(tm), GEnie(tm), and Prodigy(tm), which are operated as fee-for-service businesses. Boardwatch Magazine estimates that there are currently over 65,000 private BBSs in operation in the United States.

Networking capability exists between many BBS systems. The Internet, described below, is by no means the first or only computer network. Most BBS networks are used for transferring messages between BBS systems.

As previously indicated, BBSs generally offer software users can download at no charge, or with a minimal registration fee (software referred to respectively as "freeware" and "shareware") and allow users to upload software as well. Many BBSs have message areas where users can post messages and read messages left by others. Some BBSs cover a broad variety of topics; others are limited to a single subject area. Much of the available software on BBSs is "shareware." After downloading the shareware software, users can try it out. Anyone who likes it, and wants to keep using it is obligated to register the shareware with the developer. In return for payment, the user will generally receive the current version of the

program, possibly with additional features not available in the shareware version, and perhaps a printed manual. Even some professional software developers distribute software in this fashion. They even have their own trade association, the Association of Shareware Professionals (ASP) which sets standards for the distribution of shareware.

It is important to remember that much of this activity, no matter how educational, is essentially indistinguishable from a regular commercial business. Shareware is a means for new program developers to distribute and market their programs at a minimal cost. Many programs in use today, in the regular commercial market, were once shareware. For example, ProComm(tm), used by the Internal Revenue Service as its telecommunications program under a Service-wide site license, started out as shareware and is now a regular commercial program. Identifying what portion of this activity is exempt under IRC 501(c)(3) will be the subject of section V, below.

C. The Internet

The Internet was established in the 1970's as a Department of Defense project by the Department's Advanced Research Projects Agency (ARPA). The goal was the creation of a network that was fault-tolerant, that is, where data would automatically go around disconnected circuits and computers in the network. This system was originally known as ARPANet. In the 1980's additional impetus was provided by the National Science Foundation (NSF) and its NSFNet which, at one time formed the high-speed backbone of the Internet in the United States. NSF emphasis was on exchanging information of academic and scientific interest between colleges and universities. By the early 1990's links between computer systems were established worldwide as more and more private computers and networks tied into the Internet. What began as a government experiment is now, for the most part, in the hands of private individuals.

ARPA and NSF do not run the Internet. No one "runs" the Internet. The Internet is not itself a single entity; rather, it is an organized network of thousands of computers throughout the world that observe certain standards for transmitting information among themselves. Such standards as are set exist because of work done by ARPA in the early years of the Internet and by consensus through the Internet Society. Each computer on the Internet has an assigned "address" on the Internet, and knows the addresses of many other computers on the Internet. Communications are routed from computer to computer until the correct addressee is found (or not). The Internet, as such, is supposed to be non-commercial and

academic in nature, and its use is essentially free to all. It is a global network. Most foreign countries participate through their links to the Internet through their various public institutions.

The rapid increase in interest in the Internet has resulted in the proliferation of services to access the Internet. Some of these are offered free, or at very low cost, to persons within their service area. Sometimes these are sponsored by local governments or educational institutions. There are also many commercial access providers. Depending upon the access provider's resources and interests it may offer a variety of services ranging from e-mail facilities and anonymous file transfer protocol (FTP), to full Internet access (known as SLIP or PPP access) involving full color graphics (World Wide Web - WWW access).

D. Industry-Wide Standards Groups

With the rapid proliferation in the number of manufacturers of both hardware and software, we occasionally see applications for exemption from organizations whose exempt purpose is to establish some sort of industry-wide standard. These organizations are discussed in greater depth in section 7 of this article.

E. Advocacy Organizations

The increase in public interest in computer topics has also resulted in an increase in interest among legislators and regulators. Responding to such interest, the "computer community" has established a variety of advocacy groups to defend or promote the interests of various groups, generally in the area of First Amendment free speech rights. Although included here for the sake of completeness, these groups are not an essential part of this discussion. Applications for exemption from such entities should be handled according to the same standards as apply to any advocacy group. Many advocacy groups can qualify for exemption under IRC 501(c)(3), as educational organizations or as organizations defending human and civil rights secured by law.

F. Data Security Organizations

There are also groups such as the Computer Emergency Response Team, (CERT), based at Carnegie-Mellon University, Pittsburgh, which are essentially the volunteer fire departments of the computer community. The CERT Coordination Center's purpose is to alert members of the Internet community to

security breaches, to improve the community's awareness of computer security issues, and to conduct research targeted at improving the security of existing systems. CERT's services include 24-hour technical assistance for responding to computer security incidents, product vulnerability assistance, technical documents, and seminars. Such organizations may qualify for exemption under section 501(c)(3) as educational organizations if they are not providing consulting services for a fee or engaging in similar activities.

G. Other Bases for Exemption

Many of the activities described above can be carried out by organizations whose primary focus is something other than computers. The computer activity may be simply an adjunct or integral part of the larger exempt activity. For example, the National Genealogical Society, an IRC 501(c)(3) organization, has a computer interest group that operates a BBS.

5. IRC 501(c)(3) Exemption

The more controversial applications from computer-related organizations under IRC 501(c)(3) usually attempt to demonstrate that the organization in question is educational. Other rationales for exemption (e.g. charitable) do not generally present any unusual features. For example, an organization that collects old computers, reconditions them, and donates them to public schools is manifestly charitable. It would not matter whether the reconditioned items were computers, furniture, or shop equipment; the result would be the same.

Regs. 1.501(c)(3)-1(d)(3) defines the term 'educational', as used in IRC 501(c)(3), to mean the instruction or training of the individual for the purpose of improving or developing his capabilities; or the instruction of the public on subjects useful to the individual and beneficial to the community. The regulations do not require a formal classroom setting or traditional academic subjects. Likewise, the regulations make no distinction between educational activities that are job related and those that are not. There are many revenue rulings in the educational area that can be applied to the different types of computer-related organizations.

The "hobby club" revenue rulings are particularly applicable to computer societies and user groups previously described in section 4A of this article. Generally, hobby clubs exempt under IRC 501(c)(3) are those that conduct structured educational programs for members and the public, issue newsletters or

bulletins containing educational material, maintain reference libraries and prepare displays and exhibits for the public. Recreational and social activities must be insubstantial. The way in which the clubs select their members must be consistent with an educational, as opposed to social or recreational, purpose.

Rev. Rul. 66-179, 1966-1 C.B. 139, discusses situations under which garden clubs may qualify for exemption. In the first example, the organization was incorporated as a nonprofit organization for the purposes of instructing the public on horticultural subjects and stimulating interest in the beautification of the geographic area. In furtherance of these purposes, the organization (1) maintains and operates a free library of materials on horticulture and allied subjects, (2) instructs the public on correct gardening procedures and conservation of trees and plants by means of radio, television, and lecture programs, (3) holds public flower shows of a noncommercial nature at which new varieties of plants and flowers are exhibited, (4) makes awards to children for achievements in gardening, (5) encourages roadside beautification and civic planting, and (6) makes awards for civic achievement in conservation and horticulture. Membership in the organization is open to the public and consists primarily of amateur gardeners and others not professionally or commercially connected with horticulture. The organization's funds are derived from donations and membership dues, fees, and assessments. No part of its net earnings inures to the benefit of any officer or member. The ruling concludes that the organization is educational within the meaning of the regulations.

In the second example in Rev. Rul. 66-179, the facts are the same as in the first example except that a substantial part of the organization's activities, but not its primary activity, consists of social functions for the benefit, pleasure, and recreation of its members. Social activities are not in furtherance of any of the purposes specified in IRC 501(c)(3). Regs. 1.501(c)(3)-1(c)(1) provides that an organization will not be regarded as "operated exclusively" for one or more exempt purposes described in IRC 501(c)(3) if more than an insubstantial part of its activities is not in furtherance of a 501(c)(3) purpose. Accordingly, the organization does not qualify for exemption under IRC 501(c)(3). However this organization, in carrying out its purposes in the manner described above, is being operated primarily to bring about civic betterment and social improvements. The social functions for the benefit, pleasure, and recreation of the members do not constitute its primary activity. Accordingly, the organization qualifies for exemption under IRC 501(c)(4).

The last organization discussed in the revenue ruling was incorporated by

amateur gardeners to promote their common interest in gardening. The organization (1) holds flower shows and exhibits to display members' achievements in home gardening, (2) schedules weekly meetings devoted primarily to informal social hours during which matters related to gardening are discussed, and (3) issues a publication containing news about members' social activities and achievements in home gardening. Its funds are derived from membership dues, fees, and assessments. No part of the net earnings of the organization inures to the benefit of any officer or member. This organization, in carrying out its purposes in the manner described above, is being operated exclusively for pleasure and recreation of its members. Accordingly, it qualifies for exemption under IRC 501(c)(7).

Rev. Rul. 67-139, 1967-1 C.B. 129, uses similar reasoning to discuss the circumstances under which a gem and mineral club can qualify for exemption under IRC 501(c)(3) or IRC 501(c)(7).

The activities of many user groups are directly comparable to the first gardening club described in Rev. Rul. 66-179. Such groups maintain and operate free libraries of materials on computers and allied subjects and instruct the public on computer related topics by means of radio, television, and lecture programs. Membership is open to the public and consists primarily of amateur computer users and others not professionally or commercially connected with the computer industry. Funds are derived from donations and membership dues, fees, and assessments.

Limitation of a user group to a particular type of computer or software is not **necessarily** a bar to exemption under IRC 501(c)(3). MS-DOS(tm) and similar systems (usually referred to as PCs), generally cannot use the same software as Apple-MacIntosh(tm) or AT&T Unix-System V(tm) systems and vice versa. Disks formatted for use on one type of operating system will not work on the other. Under these circumstances, it would not be reasonable to deny exemption to such groups because they do not include all computer users. However, the existence of private benefit is always a factual question that must be resolved in each case. A user group controlled by the manufacturer, used by the manufacturer as a marketing tool or receiving a substantial portion of its funding from the manufacturer (to the point where loss of this funding would result in the dissolution of the group) might well be serving private interests more than incidentally and thus fail to qualify for exemption. This may be the situation in the case of specialized business software or hardware marketed by direct mail or by a sales force. In some cases, the manufacturer of a particular brand of software or

hardware has gone out of business, or no longer supports the product. In such cases, there is no manufacturer who benefits from the organization's activities, and consequently no issue of private benefit to the manufacturer. These computer user groups are sometimes referred to as "orphan computer" users groups, or in the case of software "orphan software" users groups.

Example 1 The XYZ Users Group serves as a forum for members to discuss and exchange research data related to XYZ software. It restricts its membership to organizations which are licensed to use XYZ software. XYZ software is produced and sold by XYZ, Inc. a for-profit company. There are no common officers or directors between the Users Group and XYZ, Inc. XYZ, Inc. did not establish the group, does not fund it, and does not use it as a marketing tool. It does, however, provide employees to run seminars and discussion groups at the Users Group's annual conference.

Under the rationale of Rev. Rul. 74-116, the XYZ Users Group would not qualify for exemption under IRC 501(c)(3) because it serves the private interests of its members, rather than a public interest.

Example 2 Assume the same facts as in Example 1 except that XYZ software is designed exclusively for use by state and local governments. Only state and local governments are permitted to join the organization.

Under these facts, the XYZ Users Group can probably qualify for exemption because it is lessening the burdens of government. The rationale of Rev. Rul. 74-116 speaks to the serving of members' private interests. Here, because the members are state and local governments, the interests being served are those of state and local governments. Furthermore, there does not appear to be other than incidental benefit to XYZ, Inc. A similar organization whose members are all 501(c)(3) organizations might also qualify for exemption.

It is important to distinguish between true users groups, where members share problems, information, and experiences, from consulting-type businesses which provide specific services to clients. See Rev. Rul. 72-369, 1972-2 C. B. 245, and B.S.W. Group, Inc. v. Commissioner, 70 T.C. 352 (1978).

Some user groups are, by their nature, of interest primarily to persons who use a particular type of software in their business or professional activities. Is this

a bar to exemption? Consider the following example:

Example 3 A user group is established for a software program used to design and manage databases. Its purposes are exclusively educational. The group holds monthly meetings at which various uses of the software and related programs and hardware are discussed and investigated. It also publishes a quarterly newsletter containing information about the software, such as announcements of "bugs" in the software and suggestions for solving problems. In addition to being distributed to members, the newsletter is provided to other user groups and local libraries free of charge. Meetings are open to the general public, as well as to members. The group is supported by membership dues. It receives no financial support from the software manufacturer. It carries on no social activities. Due to the nature of the software, most, but not all, of the members are persons who use the software professionally.

The regulations include in the definition of "educational" instruction or training of the individual for the purpose of improving or developing his capabilities. Professional capabilities are not excluded from this definition; see Rev. Rul. 65-298, 1965-2 C.B. 163, which describes a nonprofit organization, organized and operated on a nonmembership basis exclusively for the purpose of carrying on research as to diseases and other disorders of the human body and to develop scientific methods for diagnosis, prevention, and treatment thereof, and then to demonstrate the results of such research to other physicians and the public through means of seminars. The ruling concludes that the seminars and lectures presented by the organization relate to the instruction or training of the physicians attending them for the purpose of improving and developing their capabilities. Under such circumstances, the organization is engaged in an educational activity within the meaning of Regs. 1.501(c)(3)-1(d)(3).

Rev. Rul. 68-504, 1968-2 C.B. 211, describes an organization formed to conduct an educational program for bank employees in a particular urban area. The organization furnishes classrooms and employs local university professors and specialists in banking law to teach courses on various banking subjects. Credit is given by universities for hours spent in such work. No person may take the courses unless he is a member of the organization; but membership is open to employees of all banks in the area. An organization that instructs or trains individuals to improve their business or professional capabilities may be exempt under section 501(c)(3) of the Code. Thus, this organization is engaged in an

educational activity within the meaning of Regs. 1.501(c)(3)-1(d)(3).

Compare Rev. Rul. 68-504, above, with Rev. Rul. 74-116, described previously in section 2 of this article. In both cases, educational benefits are limited to members. In both cases, membership is limited to organizations or individuals who meet certain criteria. The chief difference is that in Rev. Rul. 68-504, the educational program offered is industry-wide. This is consistent with other revenue rulings regarding industry-wide training programs, such as Rev. Rul. 67-72, 1967-1 C.B. 125 (organization created by representatives of both labor and management to select individuals for apprentice training, arrange their classroom and on-the-job training, and provide books and supplies used in the training, is exempt from tax under IRC 501(c)(3)) and Rev. Rul. 72-101, 1972-1 C.B. 144 (organization created through collective bargaining agreements to train individuals desiring to acquire skills in an industry is exempt under 501(c)(3)). The rationale for denying exemption in Rev. Rul. 74-116 was private benefit to the members. If membership is open to any interested person, if nonmembers are permitted to attend meetings, and if the organization's publications are circulated to nonmembers, then it would seem that any private benefit is incidental and the organization should qualify for exemption. In fact, the membership of the organization described in Example 3 is more open than that in Rev. Rul. 68-504, as anyone may join.

With respect to computer bulletin boards, previously described in section 4B of this article, another relevant area of published precedent is that relating to libraries and other entities that distribute information to the general public. A BBS that allows users to download software is not very different from a library that allows people to borrow books. Even if the BBS charges a membership fee, that is not necessarily a bar to exemption as long as the fee is low enough to permit participation by a broad spectrum of the interested public. Similarly, limitation of the BBS to a particular topic or geographic area is not a bar to exemption. Most public libraries provide a full range of services only to persons who reside in the political subdivision which supports the library, and there are many examples of libraries limited to a specific topic, e.g. law or medicine. Further content is not relevant to qualification for exemption. Even if a BBS offers a lot of games to be downloaded by users, exemption is not necessarily precluded; most libraries have varied collections. Our answer might be different if the BBS's primary activity was the provision of a multi-user environment for the active playing of games on-line; but see the discussion of exemption under IRC 501(c)(7), at section 8, below.

More directly relevant to BBSs and Internet access services are Rev. Rul.

74-614 and G.C.M. 38050, which were discussed at section 2 above. As the G.C.M. points out, the educational purpose of any tax exempt library is the dissemination of information to the widest possible consuming public. The same rationale would apply to BBSs and other non-commercial, "public" Internet access providers.

A more difficult question is determining when otherwise acceptable educational activities become impermissible commercial activities. This issue was considered in The Council for Bibliographic and Information Technologies v. Commissioner, T.C.M. 1992-364, 63 T.C.M. (CCH) 3186. This organization, known as COBIT, was an outgrowth of Ohionet, an IRC 501(c)(3) organization which originally had four principal functions:

1. Providing its members with access to a regional library computer network for the exchange of educational and scientific information;
2. conducting research activities on bibliographic and information technologies and publishing the results;
3. offering an internally developed bibliographic computer program (TLM) to its members; and
4. making computer equipment available to its members for use with TLM at a cost substantially below fair market value.

COBIT took over the last three functions and applied for exemption under IRC 501(c)(3). The final adverse ruling issued to COBIT stated:

"You are operated to provide your member local libraries with a proprietary electronic catalogue system, software support and technological assistance, and joint purchasing activities, for which dues and assessments are charged. By providing these services, you are operated for a substantial, non-exempt commercial purpose."

In holding in favor of COBIT, the Tax Court stated that the services it provided were "necessary and indispensable" to the operations of member libraries. Because COBIT's activities bore a "close and intimate relationship to the functioning of its tax exempt members," the Tax Court held that COBIT was entitled to tax exemption as an educational institution. The Tax Court distinguished the holding in B. S. W. Group, Inc. v. Commissioner, 70 T.C. 352

(1978) by pointing out that in B. S. W. Group, the applicant was not formed or controlled by tax exempt organizations and intended to offer its services for a fee to taxable organizations as well.

Example 4 A non-profit organization is created to provide a computer based information system in a particular community. The board of directors is composed of a cross-section of community leaders. The system serves as a bulletin board regarding local concerns. For example, minutes of City Council meetings and copies of newly enacted ordinances are regularly posted. Anyone in the area may access the system. Currently there is no charge for this, although in the future the organization may charge a nominal fee (about \$5 per year) to help cover its costs. Other sources of funds will be contributions and grants. Limited Internet access is also provided. Does this organization qualify for exemption under IRC 501(c)(3)?

The answer is a definite yes. By providing access to a variety of information either free or at a nominal cost, the organization is operating in furtherance of an educational purpose. Even though some users may be businesses who use the organization's services in connection with their profit-making activities, exemption is still appropriate. Like the libraries discussed in G.C.M. 38050, the widest possible dissemination of information furthers the organization's exempt purposes.

Even if a particular organization's activities are educational, other problems may affect exempt status. As mentioned earlier in this article, some computer-related organizations are heavily involved in advocacy of one sort or another. Where advocacy is directed toward legislative activities, they may be so substantial as to preclude exemption under IRC 501(c)(3).

Another concern is private benefit. As discussed more extensively below in the section on 501(c)(6) organizations, it is possible for a users group to be organized and operated in such a way as to provide an excessive degree of private benefit to the manufacturer of the hardware or software on which the group is focused.

Another possible problem is unique to BBS's. Most BBS's provide an extensive selection of shareware for downloading by users. In many cases, this form of distribution is the only one used by the developer of the software, who will obviously derive significant financial benefits from those users who decide to

register the software. Does this result in private benefit to such a degree that exemption under IRC 501(c)(3) is precluded?

In general, private benefit must be incidental, both qualitatively and quantitatively, in order for an organization to qualify under IRC 501(c)(3). G.C.M. 37789 (December 18, 1978), explained the standard used in balancing private benefit against public benefit. Any private benefit arising from a particular activity must be "incidental" in both a qualitative and quantitative sense to the overall public benefit achieved by the activity if the organization is to remain exempt. To be qualitatively incidental, a private benefit must occur as a necessary concomitant of the activity that benefits the public at large; in other words, the benefit to the public cannot be achieved without necessarily benefiting private individuals. Such benefits might also be characterized as indirect or unintentional. To be quantitatively incidental, a benefit must be insubstantial when viewed in relation to the public benefit conferred by the activity.

With this in mind, consider private benefit in the context described above. The private benefit to the shareware creator is qualitatively incidental. The public benefit of free distribution of a vast array of computer programs cannot be accomplished without the programs being created by someone. This is analogous to a library that freely distributes books after someone writes them. Any private benefit would appear to be quantitatively incidental as well. No private benefit may actually occur. Unless the persons downloading the software like it enough (and are honest enough) to send in registration fees, there will be little or no private benefit. There are also for-profit companies who produce CD-ROM disks that are collections of shareware. These disks are then sold to the general public as well as to BBS operators who make the software freely available on their systems. However, there is probably more private benefit associated with the operation of a library, since libraries must generally purchase all of the books they lend, with the concomitant monetary benefit to the author and publisher.

Finally, let's take a look at a "computer organization" where there appears to be substantial private benefit.

Example 5 The owner of an art gallery (currently operated as a sole proprietorship) and located in a large city, which specializes in the exhibition of electronic media such as computer graphics and video, establishes an "on-line gallery." This "on-line gallery" is accessible through the Internet. Users can view works by artists who have exhibited at the art gallery. Some of these images can be downloaded.

Most can be obtained as prints by contacting the artist or the gallery. Artists sign a consignment contract to exhibit their works at the gallery. The gallery retains a 30% commission on any sales, with the remaining 70% going to the artist. Works exhibited under such contracts are automatically placed in the on-line gallery as well. The organization also plans to sponsor workshops on using electronic media, establish an electronic studio available to area artists, and apply to grantmaking agencies on behalf of individual artists. Artists will be charged fees for workshops and for the use of the electronic studio. If a favorable exemption determination is made, the sole proprietorship will be dissolved and all its activities will be taken over by the exempt organization.

Rev. Rul. 76-152, 1976-1 C.B. 152, describes an organization formed by art patrons to promote community understanding of modern art trends by selecting for exhibit, exhibiting, and selling art works of local artists, retaining a commission on sales of 10%, with the remainder going to the artists. If selected, works are displayed on a consignment basis with the artist setting the selling price. The artists have no control over the organization or its selection process. The ruling states that the artists in the subject case are being directly benefitted by the exhibition and sale of their works, with the result that a major activity of the organization is serving the private interests of those artists whose works are displayed for sale. Since 90% of all sales proceeds are turned over to the individual artists, such direct benefits are substantial by any measure and the organization's provision of them cannot be dismissed as being merely incidental to its other purposes and activities. Therefore, the organization is not described in IRC 501(c)(3).

Although additional development of this case will be necessary in order to resolve the issues presented, the facts in Example 4 are very similar to those in Rev. Rul. 76-152. Artists whose works are displayed receive 70% of the sales proceeds. This is a substantial private benefit that will probably preclude exemption. The holding in Goldsboro Art League v. Commissioner, 75 T.C. 28 (1980) is really not on point here. The physical gallery is not located in an area where there are no other art museums or galleries. Furthermore, the availability of works in the on-line gallery actually works against exemption in this case. A multitude of graphics, videos, and similar items are widely available on the Internet. Thus, the organization cannot argue that it is providing access to art to people who would otherwise not have such access.

6. IRC 501(c)(4) Exemption

As with the gardening clubs described in Rev. Rul. 66-179, some user groups in particular may have substantial social activities which preclude qualification for exemption under IRC 501(c)(3). In such cases, exemption under IRC 501(c)(4) may be appropriate, as long as social activities are not the group's primary activity. Exemption under IRC 501(c)(4) may also be appropriate for those organizations which engage in substantial legislative activities.

7. IRC 501(c)(6) Exemption

There is abundant published precedent, discussed above, in the area of computer organizations (chiefly users groups) and IRC 501(c)(6). However, these precedents need to be applied with some care and with due regard for the facts in any particular case. For example, both Guide and Prime give as a basis for denial the use of the user group as a marketing tool by the equipment manufacturer. However, it is not a given of user groups that they benefit the manufacturer more than incidentally, even though the courts seem to have made this assumption in the past. G.C.M. 39062, cited above in section 3 of this article, notes that the organization under consideration did not emerge from the common interests of the membership, but as a sales tool of the equipment manufacturer. Later, the same G.C.M. states "the existence of an organization directed to helping users make the most efficient use of their computers is **arguably** a useful sales tool in persuading potential customers to buy, rent or lease a [named brand] computer." [Emphasis added.] The G.C.M. then proceeds to assume that the existence of the users group is in fact used as a sales tool. However, we cannot automatically make such an assumption unless we have facts showing that the organization is a marketing tool. Relevant facts would include: whether the manufacturer uses the group's existence as a marketing tool; how potential new members are contacted; by whom are potential members contacted; whether current members learned of the existence of the users group before or after making a purchase; and who told them about it. Occasionally, the manufacturer furnishes the users group with a list of new purchasers, and the users group then contacts the potential members directly.

Sometimes, organizations that initially apply under section 501(c)(6) and fail to qualify may qualify under IRC 501(c)(3). This is most likely to happen in those cases where the membership is open and where at least some of the activities are open to nonmembers.

Another basis for denial under IRC 501(c)(6) is the provision of particular

services. To the extent that the organization provides specific solutions to problems its members are having, or acts as a purchasing agent to obtain discounts on equipment and supplies, it is providing particular services to its members. If that activity is the organization's primary activity, it will not qualify for exemption.

Some organizations that apply for exemption under IRC 501(c)(6) purport to be setting industry standards. In fact, the organization is trying to get one company's product or design established as the "industry standard." Obviously, such an organization cannot qualify for exemption. See, for example, Rev. Rul. 58-294, 1958-1 C.B. 244, which states that an association of licensed dealers in a certain type of patented product did not qualify as a business league where the association owned the controlling interest in the corporation holding the basic patent, was engaged mainly in furthering the business interests of its member-dealers, and did not benefit businesses who manufactured competing products of the same type.

On the other hand, it is possible for an organization whose purpose is to establish an authentic industry standard to qualify for exemption. See Rev. Rul. 70-187, 1970-1 C.B. 131, which describes an organization formed by manufacturers of a particular product to conduct a program of testing and certifying the product to establish acceptable standards within the industry as a whole and concludes that it qualifies for exemption under IRC 501(c)(6). For example, many types of businesses from the U.S. Postal Service to grocery stores to public libraries use bar codes as part of their daily operations. For such use to be possible, there must be a standard meaning established for bar codes. The organization that created and supervises this standard could, and did, qualify for exemption under IRC 501(c)(6).

It is possible for a computer related organization to qualify for exemption under IRC 501(c)(6). Given the language used in G.C.M. 39062, cited above, about a "broad-based group" being sufficient to meet the "line of business" requirement, it would seem that an acceptable limitation on activities of such a group would be at the operating system level; once a particular machine is purchased (and selection of operating system is usually determined by type of machine), the chief concern is with selecting and using other software. Any "private benefit" to the manufacturer would be to multiple manufacturers who produce many different kinds of software. Even some operating systems, such as DOS and Unix, are produced by multiple manufacturers. Thus, if otherwise organized properly, a DOS Users Group for automobile dealers or insurance companies could probably qualify for exemption. Of course, such a group must be

open to anyone in the appropriate line of business who wishes to join. Such open membership can make the organization useful even to those businesses not yet using computers.

8. IRC 501(c)(7) Exemption

Both Rev. Rul. 67-139 and Rev. Rul. 65-298, cited above, state that groups with too many social activities to qualify under IRC 501(c)(3) or 501(c)(4) may qualify under IRC 501(c)(7). Theoretically, this could also be true of those types of computer organizations which have regular meetings, such as users groups. However, such groups rarely have many social activities and in part because most of them do not limit their activities to members only. Absent such a restriction, a users group might have too much non-member income (from seminar fees, etc.) to qualify for exemption under IRC 501(c)(7).

There are also organizations whose activities are primarily social, such as BBS's that run chat lines or multi-user environments for role-playing games. Would such an organization qualify for exemption under IRC 501(c)(7)? Must commingling be face-to-face in order to meet the requirements of IRC 501(c)(7)? Or, is a "virtual clubhouse" on the Internet enough?

Rev. Rul. 55-716, 1955-2 C.B. 263, describes an organization formed for the purpose of furnishing television antenna service to its members. The only activity of the organization is the operation and maintenance of a television antenna system providing television services to its members in their homes. Furthermore, fellowship does not constitute a material part of the life of the organization, since the services do not afford an opportunity for personal contacts and fellowship among members receiving such services. The organization is therefore not entitled to exemption under IRC 501(c)(7).

Rev. Rul. 70-32, 1970-1 C.B. 132, describes a flying club providing economical flying facilities for its members but having no organized social and recreation program and concludes that it does not qualify for exemption under IRC 501(c)(7). The sole activity of the club involves the ownership, operation, and maintenance of the aircraft for use by the members. There is little commingling among members for social or recreational purposes.

Although commingling and fellowship are required for exemption under IRC 501(c)(7), the Service has not considered whether it must be face-to-face.

9. Conclusion

Although the Service's position with regard to computer-related organizations may continue to evolve, the manner for analyzing cases involving the use of computers does not. The requirements for exempt status under IRC 501(c)(3), (4), (6), and (7) do not change simply because computers are involved. Available precedents, though dated, still provide the basic framework to determine qualification for exemption.